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Duncan Wood

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THE ADMINISTRATION OF DECLINE: MEXICO'S LOOMING OIL CRISIS

*Duncan Wood**

I. INTRODUCTION

IN November 2008 Mexico's national Congress passed reform legislation that was hailed by the Calderon administration as a major step forward in the modernization of the Mexican energy sector. After months of hard negotiation between the two major parties and intense public debate, the legislation that finally emerged from the Congress was, in fact, far less ambitious than the proposal that Calderon had sent to the legislature. To many it seemed as though the entire reform package, although a positive step in the right direction, would do little to correct the multiple problems faced by Mexico's oil industry.

This paper examines the process and politics of energy reform in Mexico during the Calderon administration and argues that the ultimately gridlocked negotiations between President Felipe Calderon's ruling Partido de Acción Nacional (P.A.N.) and the dominant party in the Congress, the Partido Revolucionario Institucional (P.R.I.), have resulted in a future for Mexico that will likely see the country importing oil. Since the reform process in 2008 was hijacked by political considerations by the opposition, the mid-term elections in 2009 saw a return to majority status for the PRI, meaning that further oil reforms are highly unlikely to pass before the end of the Calderon mandate in 2012. Further, this paper argues that Mexico's oil future will only be decided once the newly determined fiscal and psychological impact of the country's change to an oil importer hits the country's political elite.

II. A BRIEF HISTORY OF MEXICAN OIL: FROM GLORIOUS REVOLUTION TO UNSTOPPABLE DECLINE

When oil was discovered in Mexico's Faja de Oro in 1910 by the British-owned company Mexican Eagle, an oil rush began that spread far beyond Mexico's borders. The instantaneous and fabulous wealth created for Sir Weetman Pearson (later Lord Cowdray) by the discovery of the Potrero de Llano well meant that other, primarily U.S., firms entered the Mexican market seeking to discover such untold riches for themselves. In

* Duncan Wood, Center for Strategic & International Studies, Senior Associate (Non-Resident), William E. Simon Chair in Political Economy.

the space of a few years, Mexico had become the world's second largest oil producer, supplying one fifth of U.S. demand.

But at the same time, due to the ongoing struggles of the revolution, political turmoil was beginning to affect the Mexican climate for production, as well as the relationship between foreign investors and the government. By 1918 Lord Cowdray had given up his interests in Mexican oil by selling out to Shell. The revolution began to impact the production levels in the oil fields, but more importantly the Constitution of 1917 had changed the balance of power between the private and public sectors in petroleum. By enshrining the principle of national ownership of sub-soil resources, the Constitution overturned the guiding principle of the Díaz regime and made foreign investors increasingly nervous about the security of their business holdings. The foreign investors began to look elsewhere for oil-related opportunities. The issue of oil became firmly established as a thorn in the side of United States-Mexican relations as Washington threatened a succession of Mexican presidents in defense of U.S. oil interests. After reaching almost half a million barrels a day in the early 1920s, Mexican oil production fell by almost eighty percent in the next ten years.¹

Although Mexico was soon left behind in terms of production levels and technology, its nationalization and the creation of PEMEX in 1938 set a precedent that would be followed years later around the world. The National Oil Company (N.O.C.) would become a model copied at different times and places, involving very different business strategies and rationales, and ultimately the N.O.C.'s would come to challenge the privately-owned International Oil Companies (I.O.C.'s) in international markets due to their control of reserves.

III. EARLY YEARS

After the creation of PEMEX in 1938 by presidential decree, the oil industry did indeed run into difficult times in Mexico. The loss of foreign capital, technology, and innovation ultimately lead to significantly declined production. Although there was never any doubt about the oil wealth under Mexico's soil, getting to it was a perpetual challenge. So why had Cardenas decided to nationalize oil? Despite the huge economic costs involved, he had chosen that particular option in response to pressure from the unions and nationalists and because it was another way to utilize anti-yanquismo to consolidate internal control. As is so often the case in the annals of Mexican history, dictates of domestic politics triumphed over economic pragmatism and long-term planning.

At the same time, the costs in terms of international relations were relatively minor. Given the increasing tensions in Europe and the slide into the Second World War, neither Britain, nor more importantly the

1. *See generally* LAURA RANDALL, *THE POLITICAL ECONOMY OF MEXICAN OIL* (1989).

United States, was willing to risk alienating Mexico at a time when the country's oil would be of enormous strategic importance. Moreover, PEMEX rapidly consolidated itself in the Mexican public's imagination as the representative of national oil sovereignty, firmly establishing itself alongside other national symbols and myths in the Mexican political pantheon. Until 1958, multiple risk contracts were permitted under Mexican law, involving cooperation with predominantly U.S. firms. But the 1958 *Ley Reglamentaria del Artículo 27 Constitucional* definitively prohibited such activities, concentrating power once and for all in the state and in PEMEX. The long term consequences of this focus on sovereignty, state control, and national pride would only become apparent much later.²

IV. BOOM TIME AGAIN

Although Mexico would become an oil importer in the early 1970s, the major discoveries of that same decade once again established the country and PEMEX as central actors in the international oil system, particularly given that Mexico was not an OPEC member state. The flow of Mexican oil onto global markets, particularly to the United States, was of vital importance in stemming the growing power of OPEC in the late 1970s and early 1980s. It was at this time that PEMEX began to assume its current legal and business form. The dramatic rise in oil production (from less than a million barrels a day in 1976 to almost three million day by 1983) and exports served to internationalize the company to a certain extent. But of far greater importance was the leadership of Jorge Díaz Serrano, director of PEMEX between 1976 and 1981. Despite his later conviction on charges of fraud and embezzlement, Díaz Serrano's understanding of the oil business, of the sector's importance for Mexican economic growth, and, most importantly, of oil production maximization, were crucial in establishing PEMEX on an international level. The discovery of the Cantarell oil field in the Gulf of Mexico occurred during this time, and Díaz Serrano was instrumental in developing the field to its full potential. Discovered in 1976 and in production by 1979, Cantarell was to become the most important field for Mexican oil production and the second largest oil field in the world. It would not be an exaggeration to say that Cantarell single-handedly saved PEMEX's position and Mexico's economy. Also during the 1970s, Mexico became a world leader in petrochemical production after significant governmental investment in the sector.³

A third factor in transforming PEMEX in the 1980s was the pressure imposed by the debt crisis. Mexico struggled to meet its international debt obligations as the drive for foreign currency intensified and the Washington Consensus began to have its full impact on Mexican eco-

2. See generally LORENZO MEYER & ISIDRO MORALES, *PETRÓLEO Y NACIÓN: LA POLÍTICA PETROLERA EN MÉXICO (1900-1987)* (1990).

3. See generally ISIDRO MORALES, CECILLIA ESCALANTE, & ROCIO VARGAS, *LA FORMACIÓN DE LA POLÍTICA PETROLERA EN MÉXICO, 1970-1986* (1988).

conomic policy-making, and PEMEX was forced to concentrate its efforts on maximizing production as a guarantee of the country's economic reputation and for access to future credit. The culmination of these efforts was to restore PEMEX's balance sheet, strengthening its position as an international oil company. But at the same time, the efforts served to prove that PEMEX was central to the Mexican government's fiscal viability and that the destiny of the company was to be determined in accordance with the financial needs of the government, not the dictates of efficiency, good business practices, and competitiveness.

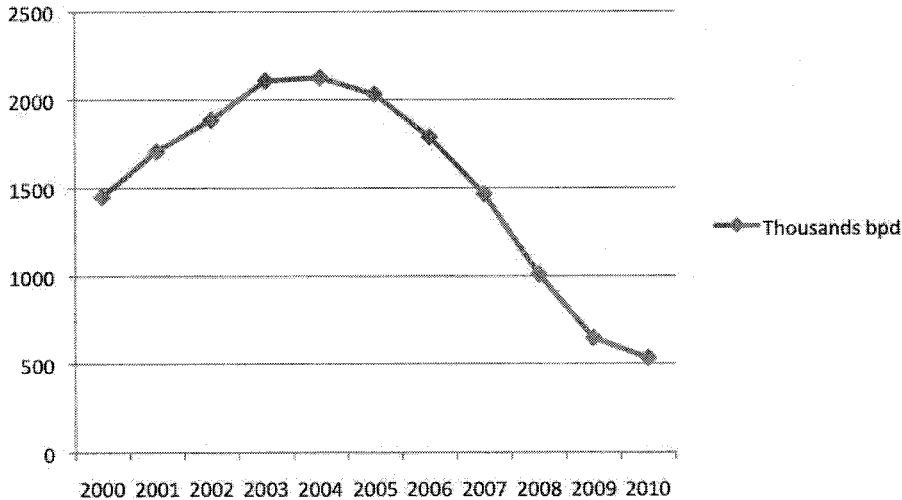
V. CONTEMPORARY PROBLEMS AND THE LOOMING CRISIS

Mexico's need for oil revenues was further compounded by the peso crisis of 1994. The continued treatment of the company as a cash cow for the government became unavoidably entrenched in this period, and came to be seen as an entirely normal state of affairs. The Mexican government had now used PEMEX as the core of its income for so long that it had become almost impossible for the government to detach itself from oil revenues. With PEMEX providing approximately one third of all government revenues, successive governments have been able to avoid the thorny issue of fiscal reform so long as the funds have kept flowing from PEMEX into government coffers.

But, more importantly, the steady and aggressive milking of the company as a source of fiscal revenue for the state has become the single biggest problem facing PEMEX today. With the government taking up to eighty percent of income, there has been little left over for investment in new exploration, infrastructure, and technological innovation. This has led PEMEX to fall behind its international counterparts since the 1980s due to its failure to develop new technologies and new production fields. The boon bestowed by Cantarell has turned out to be a double-edged sword: it gave PEMEX the production it needs to satisfy national and export demand, but also blinded the company's management and the government to the need for a long-term strategic approach to oil production.

Cantarell's fall over the past few years has been precipitous. From a high point of 2.136 million barrels per day (bpd) in 2004, production had declined to only 545 thousand bpd by the end of 2009. Cantarell was the mainstay of Mexican production for almost three decades, and its rapid decline has pushed PEMEX to scramble for alternatives. Lacking the technological and technical capacity to venture successfully into deep water exploration, where it is believed most of Mexico's remaining reserves are to be found (estimated between thirty to fifty billion barrels), PEMEX has had to look to existing wells to boost production.

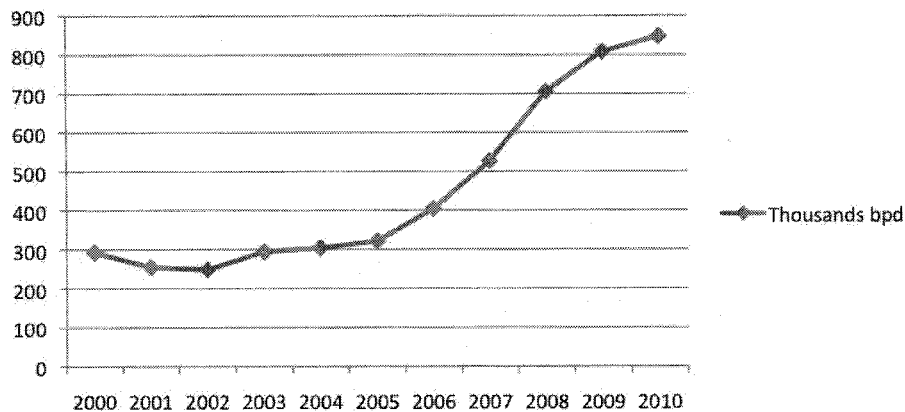
CANTARELL'S DECLINE



Source: Comisión Nacional de Hidrocarburos, *Reporte de Indicadores de Explotación al 23 de mayo de 2010*, <http://www.cnh.gob.mx/>.

This loss of over one and a half million barrels a day in oil production has been partially offset by increased production in fields such as Ku-Maloob-Zaap (K.M.Z.), which in 2008 surpassed Cantarell as the nation's highest producing oil field and continues to pump out around 850 thousand bpd. K.M.Z. will begin to decline within the next three to five years, but in the short term, it has helped to reduce the catastrophe for PEMEX.

KMZ PRODUCTION



Source: Comisión Nacional de Hidrocarburos, *Reporte de Indicadores de Explotación al 23 de mayo de 2010*, <http://www.cnh.gob.mx/>.

But, other projects that have been feted by PEMEX as holding the key to saving Mexico's oil production have not fared so well. A number of new oil fields have seen their potential as replacement fields for Cantarell exaggerated by PEMEX and the government, which has seriously weakened faith in such announcements.⁴ PEMEX's best bet under the Calderon administration is Chicontepec. This field, in small-scale production since the early part of the 20th century was, according to government estimates, supposed to be producing over 100,000 bpd by the end of 2009. This has not been the case, however, and the field had only reached 29,000 bpd by December 2009.⁵ Chicontepec holds massive reserves of oil, but is also highly complicated. Covering an area of 3800 km², it is estimated that the total reserves may reach 17.7 billion barrels. The government has estimated that by 2017 Chicontepec could produce between 550 and 700 thousand barrels per day. This will require huge investment, the development and application of new technologies, and a lot of time.

The extra production has failed to materialize despite massive investment by PEMEX, the drilling of hundreds of wells, and large-scale environmental degradation. This is mainly due to the complex geological structure of the field, which is marked by thousands of small pockets of oil in difficult rock formations. This structure makes it extremely difficult and costly to retrieve the oil deposits. Chicontepec reserves are considered low quality oil held in low permeability rock with low pressure in the reserve, thus resulting in highly complex production.

Therefore, Mexico's national oil production has fallen dramatically. From its high point in 2004 of almost 3.4 million bpd, PEMEX now produces only 2.6 million bpd.⁶ This loss of almost 800 thousand bpd from its peak and over half a million bpd since the beginning of the twenty first century threatens PEMEX's economic viability, government fiscal balances, and the national balance of payments-not to mention national energy security. Although PEMEX authorities have promised that production will not fall below 2.5 million bpd in the next few years and that production will hopefully rise to 3.3 million bpd by 2024, there is little evidence of a coherent plan to make this happen, despite the publication and Congressional acceptance of a National Energy Strategy in 2010.⁷

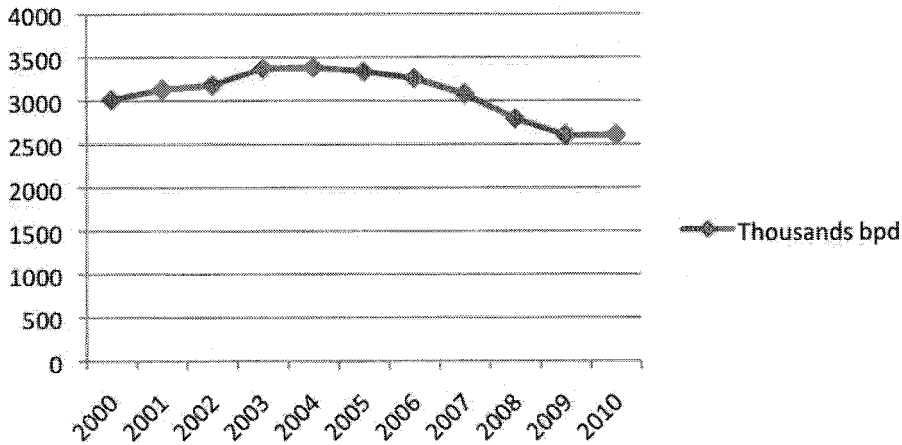
4. See generally DAVID SHIELDS, *PEMEX: LA REFORMA PETROLERA* (2005).

5. See Comisión Nacional de Hidrocarburos, *Reporte de Indicadores de Explotación al 15 de agosto de 2010*, <http://www.cnh.gob.mx/>.

6. *Id.*

7. Carlos Manuel Rodríguez, *Pemex May Need to Invest More Than \$25 Billion Yearly (Update2)*, BLOOMBERG BUSINESSWEEK, Apr. 30, 2010, <http://www.businessweek.com/news/2010-04-30/pemex-may-need-to-invest-more-than-25-billion-yearly-update2-.html>.

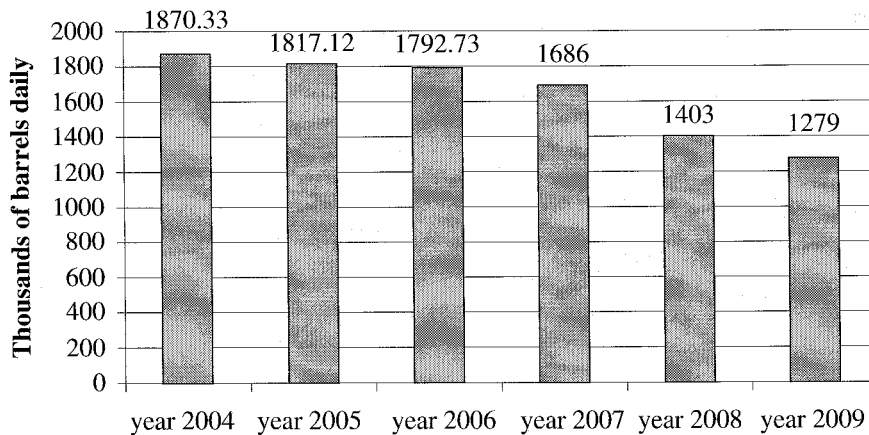
MEXICAN NATIONAL OIL PRODUCTION



Source: Comisión Nacional de Hidrocarburos, *Reporte de Indicadores de Explotación al 23 de mayo de 2010*, <http://www.cnh.gob.mx/>.

As Mexico's production has declined, so have its oil exports. As one of the most important sources of oil to the United States, this decline has obvious relevance for both U.S. energy security and for the relationship between the countries. In order to keep exports as high as possible, PEMEX has begun to resort to some desperate tactics, even sacrificing supplies of crude to its petrochemical industry to keep the oil flowing northwards.⁸

DECLINING EXPORTS



Source: PEMEX, *PEMEX in numbers*, May 2010, <http://www.ri.pemex.com/index.cfm?action=statusfilecat&categoryfileid=5440>.

8. Robert Campbell, *Mexico Cuts Petrochemicals Crude Runs, Helps Oil Exports*, REUTERS, May 4 2010, <http://www.reuters.com/article/idUSN041161820100504?rpc=60>.

The only way for PEMEX to develop new fields is through significant new investment in exploration and drilling. Estimates range from fifteen to twenty-five billion dollars a year in new investment that is needed to sustain PEMEX and avoid the importing of oil in the near future. Where this money is to come from is a crucial question. Either the government must allow the firm to keep more of its profits, or PEMEX will have to contract more debt, and as a parastatal, PEMEX's debt may be national debt.

Moreover, although it is almost certain that major new sources of oil exist in the Gulf of Mexico, these reserves are in deep water, and PEMEX lacks the technology needed to find and exploit the oil there. This leaves the company with a dilemma. It can either attempt to develop the technology itself, which will take many years, or it can consider working with other oil firms (either an I.O.C. or N.O.C.) so as to take advantage of their technological lead. Whereas the first option would greatly delay the discovery of new reserves, the second option seems to be unacceptable in Mexico's current political climate. One minor exception might be the signing of a deal with another publicly owned N.O.C. from Latin America, perhaps Petrobras. This option would solve one of the most pressing of PEMEX's problems: its lack of deepwater technology.

When these problems are combined with PEMEX's deteriorating financial balance sheet and its need for massive investment in mid-stream and down-stream infrastructure, the situation looks dire. The challenge the company faces from the deteriorating state of its infrastructure, particularly in terms of refining capacity and petrochemical production, is enormous. Abortive efforts aimed at privatizing parts of PEMEX during the Salinas and Zedillo administration have brought about a stagnation of capacity in these two areas. The 2003 Proyecto Fenix, in which private Mexican companies were invited to participate in a joint venture to build a petrochemical plant producing secondary products not covered by the Constitutional exclusion on private investment, has produced nothing. Of course, private petrochemical producers do operate in Mexico, but this has done nothing to spur PEMEX to improve its facilities or competitiveness.

As for refining capacity, by the dawn of the 21st century, PEMEX's plants were aging, and had for years been incapable of providing the Mexican economy with the fuels it needs. This has led to the rather ridiculous situation of Mexico exporting crude while importing expensive refined products such as gasoline, predominantly from the United States. In 1993, PEMEX entered into a joint venture with Shell, investing one billion dollars to expand Shell's facility in Deer Park, Texas. PEMEX became a fifty percent owner in the facility, and has since been exporting refined products from Texas to Mexico. What has always been impossible in Mexico suddenly became a reality in the United States. But this has not been sufficient to stem the decline of the nation's refineries. In 2009,

a new refinery project in Tula, Hidalgo was announced. By the time of this writing, however, the project had yet to begin its construction phase.

To overcome the problem of lack of funds and the prohibition on private investment in PEMEX, in the recent past the innovation of the *Proyectos de Inversión Diferida En El Registro del Gasto* (PIDIREGAS) (long term investment projects) has permitted some indirect private investment in the company, but doubts exist as to the sustainability of this form of financing. Moreover, as PEMEX's total debt mounts, the PIDIREGAS are an extra burden on the company, leading PEMEX to seek help from the finance ministry in May of 2010.⁹

VI. A CHANCE AT REFORM

The problem of reforming PEMEX, its fiscal burden in particular, has been a pressing question for more than a decade. Unfortunately, meaningful change in the company and in its relationship with the government has been made impossible by the polemic that has taken place within Mexico over privatization and foreign involvement. In the early 1990s the idea of privatizing the firm was publicly aired and drew a vociferous reaction from the traditionalists in Mexican society and politics, once again affirming the link between sovereignty and oil production. This tone has defined the question of what to do with PEMEX ever since. The slightest mention of reforming the company immediately solicits calls to defend sovereignty and *la patria*, negating any chance of generating a constructive debate on the topic. President Vicente Fox attempted to reform PEMEX in the early years of his mandate to no avail, and throughout his administration the company's problems grew, despite the fact that oil production reached record levels.¹⁰

When Felipe Calderón won the Mexican presidential elections in 2006 under highly controversial circumstances, his first priority became that of establishing credibility in the eyes of the Mexican people and rebuilding confidence in the office of the President. In order to do so, he took on the growing influence of the drug cartels in Mexico, a decision that has increased violence in the short term and has cost over 23,000 lives. His second priority was to begin a national debate on the future of oil production in Mexico. In order to maximize the chances of getting an eventual reform that closely reflected the Calderón administration's concerns, the government increased the frequency of public statements by Calderón, Georgina Kessel (Secretary of Energy), and Jesus Reyes Heróles (Chief Executive Officer of PEMEX), highlighting the coming crisis in the state oil company.

9. Israel Rodríguez J., *Pemex Propondrá Rescate a Hacienda*, LA JORNADA (Mex.), May 28, 2010, at 28, available at <http://www.jornada.unam.mx/2010/05/28/index.php?section=economia&article=027n2eco>.

10. See *Fox Vows Pemex Will Not be Privatized*, EFE WORLD NEWS SERVICE, July 24, 2002, <http://business.highbeam.com/436103/article-1G1-89495520/fox-vows-pemex-not-privatized>.

One speech by Reyes Heróles laid out the situation succinctly: "Overall the situation of PEMEX is critical and deserves immediate attention. The main oil field is in decline, demanding redoubled efforts and greater investment to halt it".¹¹ Referring to the need to reform the internal structure and workings of PEMEX, Reyes Heróles argued "The new management model requires greater operational flexibility in PEMEX, guaranteeing at all times the transparent handling of resources and strict accountability".¹² At this time, it seemed as though a political consensus for reform of the National Oil Company was becoming more and more likely, as important figures from the left, such as former PRD leader and PRD governor of Michoacán, Cuauhtémoc Cárdenas, and his son, Lázaro Cárdenas, both came out in favor of more autonomy for PEMEX. Cuauhtémoc even suggested that private participation in PEMEX would improve the company, a revolutionary statement for the son of the President who nationalized the oil industry in Mexico.¹³

To build on and confirm the growing movement in favor of drastic reform of Mexico's oil sector, the Calderón administration called on PEMEX to produce a diagnostic of its current problems. At the same time as its public statements, the government began to filter more and more information into the popular press detailing the coming decline in Mexico's oil production, PEMEX's lack of capacity to drill for oil in the deep waters of the Gulf, and the need for all major oil companies to share risk with other firms. In addition, a spate of government-aided and government-funded conferences on the future of Mexico's oil industry and on examples of other countries took place in 2007. In addition, the government coordinated a massive public relations campaign, namely enlisting respected academics, opinion leaders, and media personalities to communicate the government's message to the public.

The thrust of the government's argument in favor of reforming PEMEX was directed towards convincing the public that Mexico's remaining oil "treasure" or *tesoro* was hidden away in the deep waters of the Gulf of Mexico and that in order to reach it, PEMEX would need help from the private sector. This help would be either in the form of alliances, risk contracts, or incentive-based contracts. Though the government repeatedly reassured the public that privatization was not an option, the left-wing media openly accused Calderón of attempting to bring in a greater role for the private sector and of wanting to sell the national treasure.¹⁴

11. Juan Sebastián Solís, *Situación de Pemex es Crítica: Reyes Heróles*, TELEVISIÓN NEWS (Mex.), Mar. 18, 2007, <http://www.esmas.com/noticierostelevisa/mexico/612552.html>.

12. *Id.*

13. See Alma Muñoz, *Participación Estatal y Privada en Pemex, Plantea Cárdenas*, LA JORNADA (Mex.), Mar. 19 2007, <http://www.jornada.unam.mx/2007/03/19/index.php?section=politica&article=005n1pol>.

14. See Ioan Grillo, *Mexico Braces for an Oil War*, TIME, Mar. 17, 2008, available at <http://www.time.com/time/world/article/0,8599,1723153,00.html>.

The government's report on the problems facing PEMEX, titled "Diagnostico: Situacion de PEMEX," was released on the March 31, 2008.¹⁵ 128 pages long, the document laid out in detail the multiple challenges facing the National Oil Company, focusing on declining reserves and production, the ensuing problems for exports, the lack of investment in refining infrastructure, the administrative capacity of PEMEX, and the National Oil Company's financial situation. Within eight days, the government had tabled its proposal for energy reform with the Senate, sparking a debate that included the political parties, expert opinions, and the general public, which extended until the 22nd of July.

The day after the Senate debates concluded, the PRI presented its counter-proposal in the Senate, and over the next few months the major political forces came to a consensus about the acceptable content of the reform package. On the second of September PAN senators presented a bill titled "Ley para el Aprovechamiento Sustentable de la Energia," a reform package that was much less ambitious than the original proposals from the government. It was abundantly clear that the negotiations with the other main parties, and in particular with the PRI, occurred from the ninth to the twenty-third of October while the bill was debated in the Congress, with all parts of the package finally receiving approval between the 23rd and 28th of October. In the early days of November, President Felipe Calderón signed the reforms into law.

The package included seven distinct laws that can be divided into three main areas:

1. **Renewable energy and energy savings:**
 - a. Ley para el Aprovechamiento Sustentable de la Energía
 - b. Ley para el Aprovechamiento de Energías Renovables y el Financiamiento de la Transición Energética
2. **Better planning and strategic controls:**
 - a. Artículo 33 de la Ley Orgánica de la Administración Pública Federal (nuevas atribuciones a SENER)
 - b. Nueva Ley de la Comisión Nacional de Hidrocarburos (CNH)
 - c. Ley de la Comisión Reguladora de Energía (CRE)
3. **Strengthening PEMEX:**
 - a. Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo
 - b. Ley de Petróleos Mexicanos
 - c. Ley Federal de Derechos

The most important areas affecting PEMEX were: the creation of a new National Hydrocarbons Commission (CNH) that would be entrusted with the regulation of the oil and gas industries; significant reforms to the internal management structure of PEMEX; and changes to the fiscal liabilities of the company, freeing up more money for investment in Explo-

15. Secretaria de Energía & Petróleos Mexicanos, *Diagnostico: La situación de PEMEX*, Mar. 31, 2008, <http://www.pemex.com/files/content/situacionpemex.pdf>.

ration and Production activities. The reform package also brought in the possibility of issuing *bonos ciudadanos*, citizen bonds that could be sold to the public to raise capital without transferring any control of PEMEX away from the state.

The changes to PEMEX's management structure focused primarily on the board. Before the reforms, a survey of the board of governors showed that of its eleven members, six were members of the government (normally the ministers of energy, finance, environment and natural resources, communications and transport, foreign affairs, and the economy). The other five members of the board were representatives of the oil workers union, Sindicato de Trabajadores Petroleros de la República Mexicana. This guaranteed that it was very difficult for meaningful change to happen in PEMEX.

The president of the board has always been the Minister of Energy. In 2007, not one member of the board of governors had any kind of business training, leaving the firm in the hands of politicians, unions, and bureaucrats. The reforms of 2008 mandated the hiring of four new independent board members, all of whom must have a background in the oil industry and who are free from political allegiances. These *consejeros independientes* were hailed as a breakthrough in the administration of PEMEX, and their appointment was eagerly awaited.

The final reform that was touted by the government as fundamental was the prospect of new contracts for PEMEX's service providers. These contracts would offer the service providers bonuses for discovering oil, for producing more oil than had been estimated, and for producing oil faster than had been estimated. The legal opening for these contracts was at first ignored by political commentators, and it seemed to slip by opposition legislators too. This achievement by the administration was short-lived.

The government immediately hailed the reforms as game changing. The Energy Ministry released graphics and prognostications that suggested the reforms would mean the discovery of new reserves, sustained production levels, and greater efficiency for PEMEX. Although the thrust of the government's campaign had been to convince the public and political elites that the only way to save Mexico's oil production and to increase reserves was to increase private sector cooperation and venture into deep water drilling, the government immediately announced that predictions of Mexico's reserves and production figures would be revised upwards, despite the fact no fundamental opening for the private sector had in fact occurred under the reforms.

It was an amazing declaration from the government. Of course, few observers believed that the fundamental problems of the oil sector had been resolved that quickly, and the reforms were seen as having been

asfixiadas, strangled, by the political process.¹⁶ Nonetheless, it was accepted that the reforms were a small but important step in the right direction. The government should have acted to seize the moment, to implement the reforms it had worked so hard to achieve, and begin the process of fixing Mexico's oil sector.

But, despite the early enthusiasm, the government and PEMEX have been slow to act on a number of the reforms. With regard to the CNH, the institution was created within a year (its first session was held in July of 2009), but its mandate was left unclear. Intended to be an autonomous institution that would regulate the hydrocarbons sector and finally take away PEMEX's role as both regulator and operator, the CNH is located within the Energy Ministry. The law that created the CNH as a decentralized dependency of the Energy Ministry dictates that the CNH will have as its fundamental objective the regulation and supervision of the exploration and extraction of hydrocarbons. In so doing, CNH must try to:

- a) raise the rate of recovery and achieve maximum volume of crude oil and gas in the long term from wells, fields, and from active, abandoned, and declining resources, in an economically viable way;
- b) replace hydrocarbon reserves, as a guarantee of national energy security, and prospective resources, based on available technologies and the economic viability of the projects;
- c) employ the most appropriate technology for the exploration and extraction of hydrocarbons, based on their productive results and economic cost; and
- d) protect the environment and sustainability of natural resources in oil Exploration and Production (E&P).

The CNH has recently been active in questioning PEMEX's strategy in the Chicontepec field and has suggested that resources should be moved to potentially more productive and less complicated fields in the Gulf of Mexico. But it is still unclear as to exactly which function the CNH will perform, how much power it will possess to implement and prosecute its mandate, or even how independent it really is from the Energy Ministry.

As noted above, perhaps the most intriguing change in Mexico's oil scene came from the modifications to the structure of the board. By adding in four new members to the board, two of whom have voting rights, the government has theoretically shifted the balance firmly in its own favor. There was, therefore, the expectation that the government would move quickly to appoint the new *consejeros* and to rapidly implement changes.

Unfortunately, like so many issues in the Mexico oil sector, political negotiation meant that the announcement was delayed for months. Given the importance attached to internal reform at PEMEX by the gov-

16. Duncan Wood, *The Outlook for Energy Reform in Latin America*, WOODROW WILSON CTR. UPDATE ON THE AM., Mar. 5, 2010, http://www.wilsoncenter.org/topics/pubs/LAP_Energy.pdf.

ernment, the public began to suspect that the reform process was not, therefore, as urgent as it had been made out to be. The government's list of names was finally delivered to the Congress in March of 2009.¹⁷

Significantly, the reforms did not open the possibility of private participation in PEMEX or create an opportunity for PEMEX to sign joint ventures or strategic alliances with other firms in E&P. The one area of hope that emerged from the reforms of 2008 was the possibility of new contracts issued by PEMEX in 2009. These contracts, it was speculated, would provide bonus payments to private sector services that delivered on their obligations ahead of time while respecting environmental standards and to those who discovered new reserves that produced more oil than was expected or were able to get more oil from existing wells than had been expected. These contracts were expected to attract new interest in E&P among service providers (such as Halliburton and Schlumberger) but also potentially from major oil firms that possess the technology and technical know-how to explore and produce in the deep waters of the Gulf of Mexico. It was partly on this assumption that the government's new figures for future production and reserves were based.

Once again, however, delays have plagued the implementation of the reform process. Though the contracts were due to be announced in the summer of 2009, they still had not appeared by the summer of 2010. A legal challenge to the contracts is partly to blame, but this should not have prevented the government from issuing a model contract to elicit responses and opinions. A deal has been worked out with the PRI, securing its support, but still the contracts have not emerged. The delays led the PRI to call for political action against Calderón if he failed to execute the reforms in full before the fall of 2009 (though this failed to materialize). These events raise questions as to the seriousness of the Calderón administration's commitment to the energy reforms.

In February of 2010, the government sent its new Strategic Energy Plan 2010-2024 to the Congress for approval. This sparked a new debate on the need for further energy reform to maintain production levels and replace declining reserves. But, the prospects for reform before the elections of 2012 are slim. In the summer of 2009, the midterm elections in Congress overturned the PAN majority and gave the PRI control of the Cámara de Diputados. This has greatly complicated the legislative agenda for President Calderón in the remaining years of his administration. The PRI victory in the Congress means that, in order to make further reforms necessary (in all policy areas), the PAN government must engage even more closely with the party that is going to be its main rival in 2012 and must risk the PRI hijacking the reform agenda, therefore allowing the PRI to take credit for any reform that passes.

17. See Eduardo Andrade Iturribarría, *Los Consejeros Independientes*, *EL ECONOMISTA* (Mex.), Mar. 9, 2009, <http://eleconomista.com.mx/notas-impreso/columnas/factor-energia/2009/03/09/consejeros-independientes>.

Whether or not the PRI is willing to consider a new round of energy reform depends in part, of course, on the party's perception of its chances of political success in 2012 and how they believe energy reform would affect it. Should the party appear to be a shoe-in in 2012 for both President and Congress, it would make sense to seek full scale reform before the elections in order to let the PAN take the political heat and allow the new PRI government to reap the economic rewards. Allowing more private participation in oil E&P, either through more flexible contracts or through constitutional change, would remove a major problem for an incoming PRI President.

Elsewhere I have put forward three scenarios that could emerge with regards to future reforms in the Mexican oil sector.¹⁸ The first, named "The Precipice," sees Mexico rapidly approaching a crisis in oil production and oil reserves in the middle of this decade. This will cause problems in terms of fiscal revenue (Mexico still depends heavily on PEMEX for government income), PEMEX's debt balance (the company is already technically bankrupt as liabilities exceed assets), and the national balance of payments as Mexico contemplates the prospect of importing oil. At this point, and only at this point, will the political elites see the urgent need to address Mexico's oil reform challenges effectively, bringing about the opening up of the oil sector to private investment and strategic international cooperation, probably with other National Oil Companies. The second scenario, "Paving the Way," portrays a PRI that views its election prospects in 2012 as guaranteed, and seeks to enact meaningful and far-reaching reform before the next *sexenio*. In the third scenario, "Titanic Deckchairs," another round of energy reform is passed under the Calderón administration, but this will do little to stem the decline in PEMEX's production; instead, it would focus mainly on further alleviating the company's tax burden. Unfortunately for Mexico the most likely scenario remains "The Precipice," given the fact that the PRI and PAN are engaged in a bitter battle for the 2010 state elections. This battle makes a climate for constructive dialogue difficult to achieve. Furthermore, even if the PRI elites decide to support meaningful energy reform, the response from the rank and file of the party would likely be turbulent and contested.

The replacement of Jesus Reyes Heróles in the fall of 2009 by Juan José Suárez Coppel as director of PEMEX may have been an attempt by the government to seek an accommodation of sorts with the PRI. Suárez Coppel achieved a certain notoriety in the late 1990s and early 2000s as the PEMEX finance director who aided efforts to smooth over the PEMEX-gate scandal in which it was discovered that the PEMEX union, the Sindicato de Trabajadores Petroleros de la República Mexicana, had donated around \$170 million U.S. dollars to PRI presidential candidate Francisco Labastida's election campaign. If this was indeed the intention, it seems as though the ploy has failed. Suarez Coppel recently came

18. Wood, *supra* note 16, at 6.

under attack from the PRI for failing to implement the reforms of 2008 in full.

VII. CONCLUSION

The dire challenges facing Mexico's oil sector in the coming years are of immense importance for the country's economy, government finances, and for its relations with the United States. The problem of declining proven reserves for PEMEX is so bad that there is now talk of an impending crisis for both the company and the country. Mexico may become a net oil importer as early as 2015 if the current decline continues and demand keeps growing. This would be a disastrous situation for the government and the economy, as high oil prices would move from being a boon to being a severe drag on the balance of payments and economic growth.

The major challenge for PEMEX remains its declining reserves and its inability to find or access new reserves due to technological constraints. With PEMEX unable to substitute fully for the dramatic decline in Cantarell's production through Chicontepec and Ku-Maloob-Zaap, the company's proven reserves and daily production figures suggest the need for a wholesale overhaul of the sector. Mounting debts and liabilities to its workforce aggravate the situation, and recent reforms to PEMEX's financing and tax obligations have only partially addressed this.

What is needed is another national wake-up call, of the kind seen in 2008 but much more aggressive, to convince both public and political elites that the failure to shake up PEMEX will result in low growth rates, low employment, a fiscal crisis, and the very real prospect of importing oil into Mexico. The debate over oil and the subsequent energy reforms in 2008 were *asfixiadas*, and this time a broader political consensus must emerge.

But, the prospects for meaningful reform of PEMEX are not good. Although all major political actors recognize the need for reform, no consensus has emerged over the shape that reform must take. To make matters worse, the Calderón government has chosen not to risk legislative controversy and defeat and has not risked putting any proposal to the Congress. But once again, timing is crucial. Unless the legislation is passed within the first three years of the Calderón government, the chances of generating a consensus will be slim. In order to pass such legislation in the first three years, meaningful discussion and debate needs to begin now. But, there is little sign of the government seizing the initiative. A once proud national champion is slowly being brought to its knees, and political stalemate will likely prevent its reinvention.

Student Casenote

